

PERFORMANCE AUDIT  
OF THE  
CAPITAL RENEWAL DIVISION AND  
THE DESIGN AND CONSTRUCTION DIVISION  
DEPARTMENT OF MANAGEMENT AND BUDGET

July 2003



# Michigan *Office of the Auditor General* **REPORT SUMMARY**

## *Performance Audit*

### *Capital Renewal Division and Design and Construction Division Department of Management and Budget*

Report Number:  
07-125-02

Released:  
July 2003

*The Department of Management and Budget's (DMB's) Capital Renewal Division and Design and Construction Division are responsible for implementing and managing the State's capital renewal plan for State-owned infrastructure and for providing facility design and construction services to State agencies, community colleges, and universities.*

#### ***Audit Objectives:***

1. To assess the effectiveness of the Capital Renewal Division's and the Design and Construction Division's planning, contracting, and monitoring of facility construction for State agencies.
2. To evaluate the Design and Construction Division's oversight of construction projects managed by community colleges and universities.
3. To assess the reasonableness of the Capital Renewal Division's and the Design and Construction Division's billing rates for project administration and project supervision.

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#### ***Audit Conclusions:***

1. The Capital Renewal Division's and the Design and Construction Division's planning, contracting, and monitoring of facility construction for State agencies were generally effective.

2. The Design and Construction Division's oversight of construction projects managed by community colleges and universities was in compliance with State policies, procedures, and regulations.
3. The Capital Renewal Division's and the Design and Construction Division's billing rates for project administration were not reasonable; however, billing rates for project supervision were reasonable.

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#### ***Reportable Conditions:***

The Capital Renewal Division and the Design and Construction Division did not have sufficient internal control over the Project Information Management System to ensure that complete and accurate data was available to manage facility construction for State agencies (Finding 1).

The Capital Renewal Division and the Design and Construction Division did not

have procedures to ensure that project files contained complete documentation and were properly maintained (Finding 2).

The Design and Construction Division should improve documentation of its oversight of construction projects managed by community colleges and universities to ensure compliance with Section 18.1237a of the *Michigan Compiled Laws* (Finding 3).

The Capital Renewal Division had not developed a cost allocation methodology to help ensure that architectural and engineering fees billed were reasonable in relation to the actual cost of the services provided for each project (Finding 4).

The Capital Renewal Division and the Design and Construction Division should improve internal control over the allocation of project supervision hours to capital outlay projects managed by the Divisions (Finding 5).

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***Agency Response:***

DMB agreed with all 5 recommendations.

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A copy of the full report can be  
obtained by calling 517.334.8050  
or by visiting our Web site at:  
[www.state.mi.us/audgen/](http://www.state.mi.us/audgen/)



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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

July 16, 2003

Mr. Mitch Irwin, Director  
Department of Management and Budget  
Lewis Cass Building  
Lansing, Michigan

Dear Mr. Irwin:

This is our report on the performance audit of the Capital Renewal Division and the Design and Construction Division, Department of Management and Budget.

This report contains our report summary; description of divisions; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.  
Auditor General

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## **Description of Divisions**

The Department of Management and Budget's Capital Renewal Division and Design and Construction Division are responsible for implementing and managing the State's capital renewal plan for State-owned infrastructure and for providing facility design and construction services to State agencies, community colleges, and universities.

The Capital Renewal Division ensures that projects have financial resources available and monitors the overall financial status of projects. The Division assists the Design and Construction Division in administering the bid and selection process for architects and construction contractors; establishes the billing rates for charging community colleges, universities, and other State agencies for administrative and professional architectural services; prepares correspondence for the Design and Construction Division to architects, contractors, and to other State agencies; establishes the project work orders; and maintains the construction project files. In addition, the Capital Renewal Division managed the implementation of the Project Information Management System to facilitate monitoring of the construction projects.

The Design and Construction Division is responsible for providing and/or procuring professional architectural, engineering, and project management services for State facilities. The Division reviews bids for architectural and construction services and makes recommendations for bid awards; selects sites for new State facilities and surveys and evaluates existing State buildings; and assists State agencies in developing project scopes, reviewing design plans, and inspecting construction of facilities to ensure compliance with design plans and applicable laws and regulations. In addition, the Design and Construction Division provides general oversight for facility construction of projects managed by community colleges and universities.

## **Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up**

### Audit Objectives

Our performance audit\* of the Capital Renewal Division and the Design and Construction Division, Department of Management and Budget (DMB), had the following objectives:

1. To assess the effectiveness\* of the Capital Renewal Division's and the Design and Construction Division's planning, contracting, and monitoring of facility construction for State agencies.
2. To evaluate the Design and Construction Division's oversight of construction projects managed by community colleges and universities.
3. To assess the reasonableness of the Capital Renewal Division's and the Design and Construction Division's billing rates for project administration and project supervision.

### Audit Scope

Our audit scope was to examine the program and other records of the Capital Renewal Division and the Design and Construction Division. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

### Audit Methodology

Our audit procedures, conducted during April through September 2002, included examination of the Capital Renewal Division's and the Design and Construction Division's records and activities for the period October 1999 through August 2002.

We conducted a preliminary review that consisted of interviewing staff and reviewing legislation, the DMB Administrative Guide, the Management and Budget Act, the Michigan capital outlay process, the Design and Construction Division's policies and

\* See glossary at end of report for definition.

procedures, and other Design and Construction Division reports and manuals. The purpose of our preliminary review was to obtain an understanding of the Capital Renewal Division's and the Design and Construction Division's operations and to plan our audit.

To assess the effectiveness of the Capital Renewal Division's and the Design and Construction Division's planning, contracting, and monitoring of facility construction for State agencies, we tested the Capital Renewal Division's and the Design and Construction Division's internal control\* related to planning, contracting, and monitoring of facility construction. We reviewed contracts, project documentation, invoices, and other financial data. We evaluated the effectiveness of the Project Information Management System used for monitoring construction projects. We interviewed staff, architects, engineers, project managers, and inspectors. We chose a sample of construction projects and followed the projects through from the initial design phase to the construction of the facility. We compared the Capital Renewal Division's and the Design and Construction Division's actual performance with policies and procedures, best practices, and performance measures developed internally and by similar governmental entities.

To evaluate the Design and Construction Division's oversight of construction projects managed by community colleges and universities, we reviewed the oversight responsibilities delegated to the Design and Construction Division from DMB. We chose a sample of construction projects and followed the projects through from the initial design phase to the construction of the facility. We evaluated whether the duties were performed in accordance with State policies, procedures, and regulations.

To assess the reasonableness of the Capital Renewal Division's and the Design and Construction Division's billing rates for project administration and project supervision, we reviewed the Capital Renewal Division's documentation for the billing rates and for charges to State agencies and to construction projects. We examined the Capital Renewal Division's and the Design and Construction Division's cost data to determine the actual costs of services provided.

\* See glossary at end of report for definition.

### Agency Responses and Prior Audit Follow-Up

Our report contains 5 findings and recommendations. DMB's preliminary response indicated that it agreed with all of the recommendations and that it has complied or will comply with them.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and DMB Administrative Guide procedure 1280.02 require DMB to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

DMB complied with both of the prior audit recommendations included within the scope of our current audit.

# COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

## EFFECTIVENESS OF PLANNING, CONTRACTING, AND MONITORING OF FACILITY CONSTRUCTION

### COMMENT

**Audit Objective:** To assess the effectiveness of the Capital Renewal Division's and the Design and Construction Division's planning, contracting, and monitoring of facility construction for State agencies.

**Conclusion:** We concluded that the Divisions' planning, contracting, and monitoring of facility construction for State agencies were generally effective. However, we noted reportable conditions\* involving the Project Information Management System and the adequacy of documentation in project files.

### FINDING

#### 1. Project Information Management System (PIMS)

The Capital Renewal Division and the Design and Construction Division did not have sufficient internal control over PIMS to ensure that complete and accurate data was available to manage facility construction for State agencies.

Internal control consists of procedures designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with laws and regulations. Effective internal control should include procedures that prevent errors or detect errors on a timely basis and should ensure that reliable information is maintained.

The Divisions developed PIMS to collect, store, and report information for construction projects managed by the Design and Construction Division. PIMS allows users to capture both financial and strategic information from a single

\* See glossary at end of report for definition.

source and should ensure that consistent and reliable information is available for managing construction projects.

Prior to PIMS, the project directors, area supervisors, and resident inspectors individually tracked their section of projects using hard-copy documents, spreadsheets, or an Access database. PIMS was intended to replace individual tracking of projects through spreadsheets and the Access database because staff did not consistently use either of the methods; therefore, the project data was incomplete. The Divisions hired temporary staff to compile, modify, and convert the data from the spreadsheets and the Access database into the PIMS database.

We reviewed the data in PIMS after the Divisions were already using the system to manage construction projects. Our audit included an examination of the data in PIMS as of August 2002 and a comparison to the source documents in project files and to the State's official accounting records in the Michigan Administrative Information Network (MAIN) in order to evaluate the completeness and accuracy of PIMS. We reviewed 18 construction projects (which consisted of 74 related contracts) of the 1,387 total projects. Each contract may have several contract change orders and numerous payment vouchers. Our review noted:

- a. The Divisions did not ensure the accuracy of PIMS data during the conversion and updating of PIMS. We noted incomplete and/or inaccurate contract information, change orders, and payment data entered in PIMS for the 74 contracts reviewed:
  - (1) Thirteen contracts were omitted from PIMS (totaling \$5,973,268).
  - (2) Seventeen contracts were established in PIMS but did not have any data entered related to the contracts (totaling \$20,721,412).
  - (3) Ten contracts in PIMS were missing 17 change orders (totaling \$1,930,312).
  - (4) Three contracts in PIMS had 7 change orders incorrectly entered as increases to the contract authorization instead of decreases (totaling \$543,253).

- (5) Six contracts in PIMS were missing payments or had incorrect payment data (totaling \$3,074,311).
- (6) Twelve contracts did not reconcile to MAIN (totaling \$626,297).

The Divisions informed us that because PIMS was populated from the spreadsheets and the Access database, PIMS was also incomplete and inaccurate. Although the Divisions performed review procedures during and after conversion to PIMS, they still did not identify all missing data and did not reconcile financial data to MAIN. PIMS did not contain complete listings of project payments, contract modifications, or change orders; therefore, project directors had to search manual project files to determine the status of projects. As a result, project directors could not rely on the data in PIMS for managing and directing the construction projects. This may have prevented timely processing of payments, contract modifications, and change orders and may have possibly delayed construction work and project completion dates.

- b. The Divisions did not adequately develop system audit trails to ensure that users could not make unauthorized changes to PIMS. All users had unrestricted update access to PIMS, and the Divisions did not have any system or manual controls to prevent unauthorized changes or to track changes to PIMS. Consequently, the Divisions could not be assured that PIMS was accurate or reliable.

### **RECOMMENDATION**

We recommend that the Divisions improve internal control over PIMS to ensure that complete and accurate data is available to manage facility construction for State agencies.

### **AGENCY PRELIMINARY RESPONSE**

The Department of Management and Budget (DMB) will comply by January 31, 2004 by implementing Phase II to address security issues and improvements to data accuracy and completeness.

## **FINDING**

### **2. Adequacy of Documentation in Project Files**

The Capital Renewal Division and the Design and Construction Division did not have procedures to ensure that project files contained complete documentation and were properly maintained.

The Divisions are responsible for the administration, design, and construction of State capital outlay projects and miscellaneous operating projects (MOPs). In each stage of a project, the Divisions generate and receive large amounts of important documentation regarding the progress of the project. This documentation includes: requests for proposal, vendor bids and the Divisions' evaluation of bids for architects and construction contractors, bid bonds, certifications, liability insurances, contracts, design phase plans, progress meeting minutes, daily reports, schedules, payment vouchers, change orders, correspondence, and project closeout information. All of these documents are essential components of the files that need to be maintained, and the documents should be filed in a timely and organized manner to allow for effective monitoring of the construction projects by the Divisions.

The Divisions informed us that they did not have formal procedures that identified the required documentation and organization for project files. However, their informal procedures provided for files to be organized so that the bidding information, contracts, and construction and project closing documentation were kept together with a separate section for design, construction, correspondence, payment vouchers, progress meeting minutes, and resident inspector's reports.

In our review of several samples taken from capital outlay projects and MOP files during our audit, we noted that the project files were very disorganized and that the following documentation was missing from or incomplete in the project files:

- a. One of 6 capital outlay projects did not contain evaluations of the architects' cost and technical proposals.
- b. Four of 15 capital outlay projects did not have the State's Certificate of Awardability for construction contractors.

- c. One of 7 capital outlay project files and all 4 of the MOP project files did not have resident inspector's daily reports in the file.
- d. Two of 4 MOP project files did not contain any progress meeting minutes and the remaining 2 MOP project files contained an incomplete set of progress meeting minutes.
- e. One of 2 capital outlay projects and 1 of 4 MOP projects did not contain any project closeout documentation.

We met with several different staff of the Divisions about the missing documentation. The staff informed us that documents for projects may be found either with the Capital Renewal Division files or with the Design and Construction Division project managers' files. However, we could not locate the documentation in either place. The Design and Construction Division staff also indicated that neither Division had assigned responsibility to either the Capital Renewal Division staff or the project managers for maintaining and reviewing the files to determine if all appropriate documentation was developed and maintained.

Formal procedures that address the development and maintenance of necessary documentation would help to ensure that project files contain complete and accurate project history needed to effectively monitor the State's capital outlay projects and MOP projects. The procedures should, at a minimum, indicate what documentation is required and who is responsible for maintaining the project files.

### **RECOMMENDATION**

We recommend that the Divisions develop procedures to ensure that project files contain complete documentation and are properly maintained.

### **AGENCY PRELIMINARY RESPONSE**

DMB will comply by December 31, 2003 by documenting the record requirements, documenting management and individual responsibility for record maintenance throughout the life of a project, and training staff accordingly. A task force addressing documentation of records at the time of closeout is close to issuing a final recommendation at this time.

# DESIGN AND CONSTRUCTION DIVISION'S OVERSIGHT OF CONSTRUCTION PROJECTS MANAGED BY COMMUNITY COLLEGES AND UNIVERSITIES

## COMMENT

**Audit Objective:** To evaluate the Design and Construction Division's oversight of construction projects managed by community colleges and universities.

**Conclusion:** We concluded that the Division's oversight of construction projects managed by community colleges and universities was in compliance with State policies, procedures, and regulations. However, we noted a reportable condition involving documentation of the Division's oversight of projects managed by community colleges and universities.

## FINDING

### 3. Oversight of Projects Managed by Community Colleges and Universities

The Design and Construction Division should improve documentation of its oversight of construction projects managed by community colleges and universities to ensure compliance with Section 18.1237a of the *Michigan Compiled Laws*.

Section 18.1237a of the *Michigan Compiled Laws* states that DMB is required to provide architectural and professional engineering review of documents including designs, plans, and change orders at each stage of the projects managed by community colleges and universities to ensure that the project or facility is in compliance with approved program, appropriation, and capital outlay requirements. Also, DMB is required to review the award and selection of architects, professional engineers, construction managers, and other design professional service contractors and to review construction bids and monthly reports. The Design and Construction Division is responsible for carrying out these duties assigned to DMB.

We examined a sample of 20 community college and university construction projects to determine the effectiveness of the Design and Construction Division's oversight. During our review, we noted that the Design and Construction Division had procedures to review the monthly reports submitted by community colleges and universities. These monthly reports provide the current status through a project data sheet with budget breakdowns, a listing of change orders with the change order number and title and an explanation of the change, requests for

information logs, and an original and updated project schedule indicating all activities for the project.

Our review of 20 community college and university projects disclosed:

- a. The Design and Construction Division did not document its review of the need for the change orders for 7 of the 20 community college and university projects.
- b. The Design and Construction Division did not document its review and determine the propriety of the award and selection of architects, professional engineers, construction managers, and other design or construction professional service contractors for 17 of the 20 community college and university projects.
- c. The Design and Construction Division did not have a documented review of monthly reports to ensure appropriate construction progress and to identify potential problems for 8 of the 20 community college and university projects. Furthermore, 12 of the 20 community college and university projects did not submit reports monthly.

Monthly monitoring and effective oversight of projects managed by community colleges and universities would help ensure that problems are identified and resolved on a timely basis.

## **RECOMMENDATION**

We recommend that the Design and Construction Division improve documentation of its oversight of construction projects managed by community colleges and universities to ensure compliance with Section 18.1237a of the *Michigan Compiled Laws*.

## **AGENCY PRELIMINARY RESPONSE**

DMB informed us that it has complied by implementing formal acknowledgement that reviews have taken place and communicating the results of each review.

## **REASONABLENESS OF BILLING RATES FOR PROJECT ADMINISTRATION AND PROJECT SUPERVISION**

### **COMMENT**

**Audit Objective:** To assess the reasonableness of the Capital Renewal Division's and the Design and Construction Division's billing rates for project administration and project supervision.

**Conclusion:** We concluded that the Divisions' billing rates for project administration were not reasonable; however, billing rates for project supervision were reasonable. We noted reportable conditions related to project administration billing rates and internal control over project supervision hours charged to projects.

### **FINDING**

#### **4. Project Administration Billing Rates**

The Capital Renewal Division had not developed a cost allocation methodology to help ensure that architectural and engineering fees billed were reasonable in relation to the actual cost of the services provided for each project.

Section 18.1237a(6) of the *Michigan Compiled Laws* states that, for community college and university construction projects, DMB may charge a fee for services described in Section 18.1237a for review of documents, including designs, plans, and change orders at each stage of the project and construction bids and monthly reports, at a rate not to exceed actual costs. Although there are not specific statutory guidelines as to charges for State projects, sound business practices would dictate that billings for projects be reasonably in-line with the actual costs of the project administration services provided for the project.

The Capital Renewal Division's current methodology is to bill 1% of the authorized project cost up to a maximum of \$500,000 and a minimum of \$150,000 for projects managed by community colleges and universities. For State agency-managed projects, it bills either 1.5% or 5% of the authorized project cost, depending on the project. However, the Capital Renewal Division did not conduct a cost analysis to support that these percentages were reasonable in relation to the actual costs of services provided for each project.

We compared the fees collected over a three-year period with the cost of services provided by the Capital Renewal Division and the Design and Construction Division. We were able to determine that the total amount of fees charged by the Divisions did not exceed the total costs incurred by the Divisions. However, we concluded that the Divisions' allocation of charges to the various State projects, community college and university projects, and MOPs was not reasonable. We noted that some projects may have been overbilled by as much as 58% and some underbilled by as much as 73%.

Comparison of actual cost per project to the billing rate would help to ensure that the allocation of billings and source of payment accurately reflects the project administration costs related to the construction project and help to ensure compliance with applicable statutes.

### **RECOMMENDATION**

We recommend that the Capital Renewal Division develop a cost allocation methodology to help ensure that architectural and engineering fees billed are reasonable in relation to the actual cost of the services provided for each project.

### **AGENCY PRELIMINARY RESPONSE**

DMB will comply by December 31, 2004. The Capital Renewal Division concurs, in part, with the finding, but agrees that its documentation and method for determining reasonable rates can be improved. DMB will develop and implement a cost allocation methodology more reliant on internal cost allocation data rather than industry statistics.

### **FINDING**

#### **5. Internal Control Over Project Supervision Hours Charged to Projects**

The Capital Renewal Division and the Design and Construction Division should improve internal control over the allocation of project supervision hours to capital outlay projects managed by the Divisions.

Section 18.1244(1) of the *Michigan Compiled Laws* states that DMB shall determine the need for and provide on-site supervision of capital outlay projects and may pay for the resident inspectors' salaries from the projects' accounts. Any

direct labor charges must be made in accordance with the systems or procedures prescribed by DMB.

The Design and Construction Division's resident inspectors oversee on-site construction of capital outlay projects, and the Capital Renewal Division developed the methodology to allocate project supervision costs. During our audit period, the prescribed methodology for billing projects for the resident inspectors' salaries for project supervision was to use actual time spent on the projects.

We reviewed a sample of five different pay periods from October 1999 through May 2002 and compared the regular hours recorded per the State's payroll system to the approved project supervision invoicing reports for the same pay periods. The Divisions incorrectly billed projects for holiday, annual, and sick leave hours for 460 hours totaling \$22,221 for the five pay periods reviewed. We also noted that the Divisions billed one project for 76 hours that were actually spent supervising two other projects. The Divisions changed their billing procedures in fiscal year 1999-2000 to exclude holiday, annual, and sick leave hours; however, not all of the resident inspectors properly implemented the new procedures. We further noted that the Capital Renewal Division sometimes reallocated hours to projects without documentation for the change.

The Design and Construction Division informed us that resident inspectors submit their time sheets, which are the basis for the hours recorded in the payroll system, prior to the end of the pay period. In addition, resident inspectors submit a project supervision invoicing report that represents their allocation of time to various projects, which is the basis for billing hours to projects. Furthermore, the Design and Construction Division informed us that changes are often made to the time sheets and not carried forward to the invoicing reports and are not discovered because the Design and Construction Division does not compare the invoicing reports with the time sheets to ensure that the hours agree.

Because DMB did not have effective internal control, some projects were billed for hours not actually worked or for hours worked on different projects.

**RECOMMENDATION**

We recommend that the Capital Renewal Division and the Design and Construction Division improve internal control over the allocation of project supervision hours to capital outlay projects managed by the Divisions.

**AGENCY PRELIMINARY RESPONSE**

DMB informed us that it has complied by comparing the project supervision invoices to the time entered into the Data Collection and Distribution System to verify that the information is accurate and reflects actual charges.

## **Glossary of Acronyms and Terms**

<b>DMB</b>	Department of Management and Budget.
<b>effectiveness</b>	Program success in achieving mission and goals.
<b>internal control</b>	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
<b>MAIN</b>	Michigan Administrative Information Network.
<b>MOP</b>	miscellaneous operating project.
<b>performance audit</b>	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
<b>PIMS</b>	Project Information Management System.
<b>reportable condition</b>	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.